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ABSTRACT

This paper offers information and analysis of the direct lending portion of the reauthorization of the Higher Education Act of 1965. The direct lending proposal is described in an opening letter to the reader as a provision that would make the Pell Grant Program an entitlement and raise the maximum award to $4,500 with provisions that would establish a single need analysis system, phase out several current programs by 1994, and establish a direct loan program in its place. The materials presented in this document relate to that proposal. A first section presents background on the issue including a discussion of how the proposal got underway and the Secretary of Education's initial assessment of the idea. Included here are materials from the Education Secretary, Lamar Alexander, detailing direct student loan options: the current programs with proposed policies, a full direct loan program, a mixed program, and expansion of the current direct loan program. Also presented is the draft legislation from the House of Representatives on direct lending along with a synopsis of that legislation. A letter from Representative Robert E. Andrews discusses the direct loan program and a paper from the Student Loan Marketing Association offers criticism of the proposal. A final section presents additional issues for consideration. (JB)

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Assessing the Progress of Reauthorization:

An Examination of Direct Lending

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25TH ANNIVERSARY 1966-1991

October 1991

Dear NASFAA Member:

On October 8, the House Subcommittee on Postsecondary Education completed its consideration of its reauthorization bill (which is being referred to as the Higher Education Technical Amendments of 1992), and referred the Committee print to the full Committee on Education and Labor. Among the key elements of the bill are provisions that would make the Pell Grant Program an entitlement and raise the maximum Pell Grant award to $4,500; provisions that would establish a single need analysis system that incorporates several pieces of NASFAA's Plan for Reform; and provisions that would phase out the current Stafford, SLS, PLUS, and Perkins Loan programs beginning in 1994 in favor of a direct loan program. The enclosed materials relate to the direct lending proposal that was included in the Committee print.

The concept of establishing a direct lending program is not new, but changes brought about as a result of the Credit Reform Act and continuing concerns over the operation of the existing Guaranteed Student Loan (GSL) programs have prompted many to reexamine the issue and to call for such a program to be enacted during this reauthorization of the Higher Education Act. Considering the seriousness of such a policy change, the impact upon postsecondary education funding and the effects that it would have upon the student aid operational structure, we believe it is important that the matter receive careful review and consideration.

To date, NASFAA has not taken a position on a direct lending program, believing that it would be inappropriate to do so until specific details had been fully advanced describing how such a program might work. The direct lending proposal included in the House Committee print clearly outlines such an approach; therefore, we are providing information so that you may formulate your own opinions on this important issue. We have included materials prepared by both proponents and opponents of the idea, and have developed a number of other questions for your consideration.

NASFAA's Board of Directors will discuss direct lending at their November meeting. We encourage you to share your thoughts with us by November 1.

Finally, we also encourage you to share your thoughts on this and other issues with your representatives in Congress. Your input and expertise in this reauthorization process will certainly be crucial in our collective efforts to expand educational opportunity for students.

Sincerely,

Dallas Martin
President

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Background

The idea of establishing a National Student Loan Bank has been raised several times over the past 25 years, but seldom has it gone beyond the discussion stage. In early January of 1991, a variation of the idea again was raised when several major newspapers (*The New York Times*, January 7; and *The Wall Street Journal*, January 8) reported that the Bush Administration was likely to advance a new institutional direct lending program to replace the existing Guaranteed Student Loan Program as a part of its Fiscal Year 1992 (FY-92) budget. The reports also indicated that direct lending would be less costly to the government that the existing program and could save up to a billion dollars per year. A few days later, it was learned that the story was a premature leak that had come from a Department of Education (ED) internal taskforce that had been studying the idea. While some in the Administration favored the idea, others, primarily at the Office of Management and Budget (OMB), did not. Consequently, the proposal was not included as a part of the Administration's budget proposal.

Instead the Administration indicated that the idea was still under consideration, but that ED's first priority would be to improve the management and oversight of the existing programs.

The renewal of the idea, however, struck a responsive chord with others in the education community, and discussions on the merits of such a plan began to occur. By early April, the American Council on Education (ACE) and the other five presidential associations proposed that a pilot direct lending program be enacted as a part of Reauthorization, enabling institutions with a proven management record to be eligible to participate.

Meanwhile, discussions over the pros and cons of direct lending continued, with many still questioning whether or not the Administration's earlier claims would in fact produce the savings that were stated. To this end, on April 25, Representative William D. Ford, D-Mich., Chairman of the House Education and Labor Committee and the Postsecondary Education Subcommittee, wrote to Secretary of Education Lamar Alexander requesting that the Department's internal analysis be provided to the Committee on Education and Labor. On June 28, Secretary Alexander responded to Chairman Ford in stating, "As you know, although the Department has considered restructuring the student loan program to include a Federal direct loan program, the Administration's Reauthorization bill does not contain a proposal for any kind of direct loan approach."

The Secretary's letter also noted that, "The Department's focus at this time is on resolving problems in the current GSL programs." The Secretary indicated, however, that he wanted to provide the Committee with information that would assist in their review and, therefore, sent them the options paper [which is included as part of this publication] developed by Department staff, a draft review of the staff's financial projections prepared by Kidder, Peabody & Co., Inc., and an analytical outline that raises questions that should be addressed for a full scale developmental effort. The Secretary's letter also went on to say:

> "In addition to the information contained in the enclosures, I believe that the following issues must be considered for any direct loan option. They are:
>
> 1. Increased Federal debt. The direct loan approach envisions capital raised by the Federal Government. Budget scoring under the Credit Reform Act would not 'count' this capital as budget authority or outlays, but this borrowing would still have a very direct negative impact. It adds directly to the national debt. At current volume projections, roughly $10 billion (the unsubsidized portion of loan volume) would have to be borrowed by the Federal Government in the first year. Over a 20 year period, borrowing would be between $200 and $300 billion. Loan repayments would not be material for many years.
>
> 2. Risk to the Federal Government. The current problems in the financial industry clearly demonstrate the importance of considering risk to the Government in any new policy venture. The Federal direct loan option would shift all loan risk to the Federal Government. Knowledgeable individuals may disagree on the extent to which the current reinsurance rules and lender guarantee agency due diligence requirements actually share risk, but there is no question that the Federal Government's risk is now less than 100 percent.
>
> 3. Management of the program. The use of contractors for loan servicing and default collection does not in any way reduce the complexity or enormity of the Federal administrative tasks inherent in starting up a direct loan program while at the same time winding down the guaranteed program and managing that program for some considerable period into the future. This Department is not currently prepared for such tasks. Our management review of the administration of the loan programs has made that abundantly clear. My new management team needs time to put new systems and procedures in place.
>
> Much of the bill I sent to Congress concentrates directly on combatting problems in the behavior of institutions in the current loan programs. Obviously, most postsecondary institutions are sound managers of their current loan program responsibilities, but it is just as obvious that many are not. I do not believe this is the time to move to greatly enhanced reliance on institutions. The reforms we propose should be enacted first and given time to take effect."

In addition to the concerns raised by the Secretary, the accompanying material reviewing projected savings of the Department's direct lending program (conducted by Kidder, Peabody & Co., Inc.) did confirm that the Department should be able to "realize 10 percent to 15 percent value savings over the life of the loans through such a program."

Kidder/Peabody's report did note, however, that their analysis:

- assumed that ED would charge the student borrower a full 8 percent guaranty/origination fee;
- suggested that ED's savings projections are budget figures rather than "pure" economic savings because of the Credit Reform directives and methods of costing which were used;
- believed that ED's Treasury rates may be too aggressive, therefore, causing an understatement of costs; and
- projected that 18 guaranty agencies would become insolvent during a phase-down and would require an additional $200 million to remain solvent.

In conclusion, Kidder/Peabody stated that ED must carefully consider the specific structure of a direct loan program and whether certain modifications to the GSL program might produce a portion of the savings with far less dislocation to the present program participants. As July approached, it seemed clear that the Administration had finally decided to concentrate its efforts upon improving the management of the existing GSL program and postponing any consideration of direct lending.

On the Congressional front, Representative Robert E. Andrews, D-N.J., a member of the House Postsecondary Education Subcommittee believed that in spite of some of the

obstacles, direct lending was the best way to proceed. On August 1, Rep. Andrews introduced H.R.3211, a bill to establish a direct federal lending program under which the existing GSL program would be consolidated.

The Andrews measure, for the first time, provided everyone with a much more fully developed direct lending program model. Many of the lingering questions over program structure and loan terms at last were defined in the Andrews bill, and proponents and opponents alike agreed that everyone could begin to analyze the measure more carefully.

Finally, on September 25, a revised version of H.R.3211 was included within the Committee print, released by the House Postsecondary Education Subcommittee staff, thereby providing a more complete proposal and a fuller explanation of how the new program would be phased in over the next five years.

The issue of direct lending is now being considered very seriously by the House Education and Labor Committee. While consideration of the measure was deferred in the Subcommittee markup, it will be fully discussed by the full Committee when it begins consideration of the reauthorization bill.

Clearly the idea of direct lending appeals to many aid administrators in that it would make the application and awarding of aid easier for students. Still, there are numerous questions and issues that need careful consideration.

We have compiled the following materials for you to study so that you may formulate your own opinions on what will work most effectively for your institution and your students. In addition, we have attempted to identify a number of issues or questions, following these materials, which we hope will be useful in your review.

When you have completed your analysis, please let us know you what you have decided. Any comments or suggestions that you have will be appreciated.

(NOTE TO NASFAA READERS: THIS INFORMATION ACCOMPANIED SECRETARY ALEXANDER'S 6/28/91 LETTER TO THE HONORABLE WILLIAM FORD)

Direct Student Loan Options

OPTION I: MAINTAIN CURRENT LOAN PROGRAMS AND PROPOSED POLICIES (AS PRESENTED IN THE FY 1992 BUDGET)

Current Program Proposals: The Department's FY 1992 budget is based upon a wide-ranging set of proposed legislative changes to the GSL programs. Among other things, these changes would increase loan limits, strengthen the guarantee agency structure, and tighten the links between the States and guarantee agencies. In addition, the focus of a number of the proposals is the reduction of default costs through default prevention and the improvement of default collections.

For the current National Direct Student Loan (Perkins) program, the budget would not provide any new Federal loan capital, relying instead on lending from repayments by students who had previously received Direct Loans. (Approximately $5 billion is outstanding in revolving funds at institutions of higher education, from which approximately $700 million in new capital becomes available for new loans each year from repayments.)

Pros

- Making structural and substantive improvements to the current system will work better than trying to set up a new system that is bound to have transition problems.
- The current GSL system is highly decentralized. Its use of competing private lenders and guarantee agencies ensures prompt and client-oriented services nationwide.
- State-level guarantee agencies can work closely with State-level higher education licensing and other agencies in policing the quality of schools and in tracking student loan defaulters.
- The Department can provide new energized leadership for the program. Because of abuses, Congress has been more willing to enact major changes. Several Administration reform proposals affecting institutional eligibility and default reduction were enacted by the Congress in the 1990 budget reconciliation bill.

Cons

- Guaranteed loans are significantly more expensive to provide than direct loans ($1.4 billion more expensive in the first year than a comparable Direct Loan Program). See Tab A *[Note to NASFAA readers: Tab A is not included in these materials]*. This is due to (1) the entitlement subsidy payments needed to attract and maintain the participation of private for-profit lenders, and (2) the administrative and default collection allowances paid to guarantee agencies.
- Due to its complexity--the great number of participating organizations, decentralized record-keeping, and thousands of transactions--the current GSL system is error prone and extremely difficult to monitor and audit.
- Recent fraud and abuse scandals involving lenders and servicing contractors (e.g., Florida Federal, FITCO, UES/Bank of America) are only the latest in a long history of such scandals which State-level guarantee agencies have been unable to prevent.
- The GSL system is burdensome to students and schools. Students have to fill out multiple applications for student aid (one for GSL and one for all other aid). There are often delays to obtain lender and guarantor approval of loans. Because most loans are transferred among lenders and servicers, borrower repayment checks may be sent to the wrong party. Schools now must deal with up to 54 sets of applications, regulations, program reviews, and reports prescribed by 54 guarantee agencies.
- GSL program changes have always been "held hostage" by the banks--who can always threaten to withdraw. Likewise, guarantee agencies have historically fought reforms detrimental to their interests.

OPTION II: FULL DIRECT LOAN PROGRAM

Proposal: All program components of the current GSL system (Stafford Loans, SLS and PLUS loans) would be replaced by loans with similar borrower interest and other terms delivered via an expanded Direct Student Loan system. Capital would be raised through off-budget Treasury borrowing consistent with the Credit Reform Act of 1990. Loans would be disbursed by schools, just as in the current GSL system. Capital allocations to schools would be based upon estimates, and later updates of student needs. The current roles of major intermediaries--private lenders, secondary markets, and guarantee agencies--would be eliminated. However, private servicing and collection firms would have the same roles they now have--but without the middlemen. They would be competitively selected and closely monitored Department contractors. The same increased loan limits, default prevention and collection improvement proposals contained in the current 1992 budget proposals could be pursued under the new structure.

Estimates of the savings from this option are attached as Tab A. So that the savings estimates would reflect only the potential structural change from guaranteed to direct student loans, we assumed that direct loans would be make on the current GSL borrower interest terms. Also, it should be noted that the estimates take into account GSL phase-out costs (i.e., Department claim payment and collections on the outstanding GSL portfolio) during the initial five-year period.

Pros

- Direct loans would be significantly less expensive than guaranteed loans. The Government can borrow at lower rates (the Treasury bill rate) than can private sector lenders. Direct loans would not have to provide middlemen with a profit. Also, various functions, such as marketing and guarantor review of claims, would be eliminated. ED has estimated total savings at $1.4 billion in the first year (1993) and $6.6 billion cumulative over the first four years (1993-96). See Tab A for details.
- The savings that could be realized from an expanded Direct Loan program could be reallocated to other current education programs (which some in Congress appear to favor) or be turned back to the Treasury to reduce the Federal budget deficit which would help both taxpayers and the financial markets.
- The savings could also be plowed back into the Direct Loan program in the form of reductions in repayment burden (e.g., through eliminating loan origination fees and/or reducing borrower interest rates).
- A Direct Loan program would be easier to manage and would greatly reduce opportunities for error and abuse. A centralized data base would improve data integrity and auditability. Department monitoring could be focused entirely on the postsecondary institutions and the collection contractors.
- Such a system would be built upon a base of Education Department expertise in two key areas: (1) allocating funds to schools (as in the Pell Grants and Campus-based student aid programs), and (2) contracting directly for student loan collections. ED has performed these functions well for many years.
- Student loan availability would be more dependable because it would no longer depend on financial market conditions and individual bank policies. Access would be better assured to small loan amounts, loan consolidation, forbearance, and flexible repayment schedules that banks may find unprofitable.

Cons

- Expanding Direct Student Loans and eliminating the role of private lenders would be seen as a major shift toward centralized Government activity and away from the use of private sector solutions.
- Likewise, eliminating the role of State-level guarantee agencies would be seen as a shift toward centralized Federal Government activity and away from decentralized State-level activity at a time when the Administration's policies seem to be moving in the other direction. This proposal could be viewed as being inconsistent with the President's FY 1992 budget request which includes a massive new block grant to States--designed to move control over dollars and programs closer to the taxpayer and the consumer.

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- A major Direct Student Loan expansion would require new ED staffing and administrative costs in the near term and new challenges at a time when the Department is having difficulty managing current programs.
- Introducing a new system would entail transition risks and could reduce the availability of loans if implementation is not smooth.
- At a time when the U.S. banking industry is in a weakened condition, eliminating GSL subsidies may affect the financial viability of some banks, which in turn would add problems to other Federal agencies, to citizens whose funds are being held by such banks, and to taxpayers if the banking industry requires further public relief.

OPTION III: MIXED PROGRAM

Proposal: This approach would use a Direct Loan delivery system to replace only the highly subsidized, need-based Stafford Loans to students. It would retain the GSL structure--private lenders and State-level guarantee agencies--for delivery of the less-subsidized and non-need based PLUS and SLS loans which more closely resemble private sector loans.

Pros
- Potential problems related to phase-out of the entire GSL system could be mitigated or avoided. Since guarantee agencies would remain in business, they could be allowed to retain their reserve funds and they may be more willing to work out their own Stafford Loan portfolios.
- Student loans for the neediest students would be more assuredly available than under the current GSL structure; while PLUS/SLS loans would be made by banks to their more normal customers--middle/upper income families--using normal banking standards of creditworthiness.
- Loan delivery would be much simpler than under the current GSL system; the Department's monitoring burden and the potential for error and program abuse would be reduced.
- Federal subsidy costs would be reduced, although not as much as under the full Direct Loan proposal.

Cons
- This approach would potentially produce a lower level of Federal savings than the full Direct Loan proposal.
- It would leave some continuing program complexity along with related problems. Thousands of lenders, servicing agents, secondary markets, and 54 guarantee agencies, and transactions among them, would still need to be monitored.
- Like the full Direct Loan proposal, it would raise the specter of "big Government" displacing private and State-level activity. Each of the "cons" listed under Option II would still hold true for this option.

OPTION IV: EXPANSION OF CURRENT DIRECT LOAN PROGRAM

Proposal: The Department would provide substantial new Federal capital contributions to the current Perkins Loan (formerly National Direct/Defense Loan) program--using off-budget Federal financing consistent with Credit Reform. This option would gradually expand the current decentralized Perkins Loan program, with school-level revolving funds and school responsibility for contracting with servicers. The entire GSL system (Stafford Loans, SLS, and PLUS) would remain intact at the present time. However, an expanded Perkins Loan program would compete with the GSL system and could gradually reduce demand for GSL loans over time. The terms of this competition could be make identical, allowing a fair competition between the two systems.

Pros
- Except for the new capital infusion, this approach involves no change from current student loan structure.
- A Perkins Loan expansion approach would allow more time to strengthen Department loan management, would allow more time for a transition to a complete Direct Loan approach (e.g., with Federal contracting for loan servicing and collecting), and would facilitate the transition for a phase-out of current GSL system participants.
- Any expanded Perkins Loan availability would better ensure loan accessibility, especially with respect to small loan amounts that banks find unprofitable. It would also provide some protection against major bank withdrawals from GSL due to changing economic or banking industry circumstances.
- Budgetary savings would be realized to the extent Perkins Loans are used instead of Stafford Loans.
- Over time, the Administration and Congress could evaluate the cost-effectiveness and other benefits of replacing Stafford Loans with Direct Loans. Moreover, students and schools could "vote" through their choice of direct loans or guaranteed loans, assuming they are offered on the same interest terms.

Cons
- There would still be substantial program complexity for some time. The GSL system, with its related monitoring and accountability problems, would continue, albeit at a gradually reduced size as its role in the overall system diminishes.
- Federal cost reduction would be much less than under Options II or III.

els comparable to traditional academic programs; recognizes the educational role of work-learning supervisors; and includes consequences for nonperformance or failure in the work-learning program similar to the consequences for failure in the regular academic program.

PART D—FEDERAL DIRECT LOANS

SEC. 451. ESTABLISHMENT OF FEDERAL DIRECT LOAN PROGRAM.

Part D of title IV of the Act is amended to read as follows:

"PART D—FEDERAL DIRECT LOANS

"SEC. 451. PROGRAM AND PAYMENT AUTHORITY.

"(a) PROGRAM AUTHORITY.—The Secretary shall, in accordance with the provisions of this part, carry out a direct loan program for qualified students at institutions of higher education to enable the students to pursue their courses of study at such institutions during the period beginning on July 1, 1994.

"(b) PAYMENT AUTHORITY.—The Secretary shall, from funds made available under section 457, make payments under this part for any fiscal year to each institution of higher education having an agreement under section 452, on the basis of the estimated needs of the students of that institution for student loans taking into consideration the demand and eligibility of such students for subsidized and unsubsidized direct loans under this part.

"(c) PAYMENT RULES.—

"(1) IN GENERAL.—The Secretary shall make payments required by subsection (b) of this section in such installments as the Secretary determines—

"(A) reflects accurately the disbursement of funds for student loans by the institution of higher education concerned, and

"(B) will best carry out the objectives of this part.

"(2) INITIAL PAYMENTS.—The initial payments for any academic year required by subsection (b) shall be made available to institutions of higher education not later than July 1 for the academic year which begins on or after that date. Payments of entitlements by the Secretary under this part shall be made promptly.

"(d) ENTITLEMENT PROVISION.—An institution whose application has been approved by the Secretary under section 452(b) shall be deemed to have a contractual obligation from the United States for making the payments specified in that application.

"SEC. 452. APPLICATIONS OF AND AGREEMENTS WITH INSTITUTIONS OF HIGHER EDUCATION.

"(a) APPLICATION REQUIRED.—

"(1) IN GENERAL.—Any institution of higher education desiring to receive payments from the Secretary under this part shall make an agreement under subsection (b) and shall submit an application for such payments to the Secretary in accordance with the provisions of this part. The Secretary shall set dates before which such institutions must file applications under this section. Each such application shall contain such information as is necessary to assure the correctness of estimated need for funds for students at the institution of higher education.

"(2) FIRST COHORT OF INSTITUTIONS.—For the academic year beginning July 1, 1994, the Secretary shall make agreements with not less than 450 institutions but not more than 500 institutions. Agreements with institutions for the academic year beginning July 1, 1994, shall be concluded by July 1, 1993, and the Secretary shall publish the list of the institutions with which he has concluded agreements in the Federal Register not later than July 1, 1993. For the academic year beginning July 1, 1994, the Secretary shall make agreements with institutions which represent a cross-section of institu-

tions of higher education in terms of size, geographic location, length of program, control and composition of student body.

"(3) SECOND COHORT OF INSTITUTIONS.—For the academic year beginning July 1, 1995, the Secretary shall make agreements with not less than 950 institutions but not more than 1,000 institutions in addition to the institutions with which the Secretary made agreements for the academic year beginning July 1, 1994. Agreements with institutions for the academic year beginning July 1, 1995, shall be concluded by July 1, 1994, and the Secretary shall publish the list of institutions with which he has concluded agreements in the Federal Register not later than July 1, 1994.

"(b) AGREEMENT REQUIRED.—An agreement with any institution of higher education for the payment of advances under this part shall—

"(1) provide for the establishment and maintenance of a program at the institution under which—

"(A) the institution will identify eligible students at the institution, in accordance with section 484;

"(B) the institution will estimate the need of each such student as required by Part F; and

"(C) the institution will originate loans to such eligible students in accordance with this part;

"(2) provide assurances that the institution will comply with the provisions of section 463A, relating to student loan information;

"(3) provide that the note or evidence of obligation on the loan shall be the property of the Secretary and that the institution of higher education will act as the agent for the Secretary only for the purpose of making loans under this part; and

"(4) include such other provisions as may be necessary to protect the financial interest of the United States and promote the purposes of this part as are agreed to by the Secretary and the institution.

"(c) ADMINISTRATIVE EXPENSE PROVISION.—An institution which has entered into an agreement under subsection (b) shall be entitled, for each fiscal year during which it makes student loans under such agreement, to a payment in lieu of reimbursement for its expenses in administering its student loan program under this subpart

during such year. Each such payment shall be made in accordance with section 489 or shall be an amount equal to $20 per academic year for each student enrolled in that institution who receives a loan under this part for that year. Payments received by an institution under this subsection shall be used first by the institution to carry out the provisions of section 489(b) of this Act and then for such additional administrative costs as that institution determines necessary. An institution which has an agreement under subsection (b) shall be deemed to have a contractual right to the payments required by this subsection.

"(d) EXEMPTION FROM TRUTH IN LENDING ACT.—An institution which has entered into an agreement under subsection (b) shall not be subject to the Truth in Lending Act with regard to loans made under this part.

"SEC. 453. ELIGIBILITY FOR AND AMOUNT OF LOANS.

"(a) ELIGIBILITY.—

"(1) COMMON ELIGIBILITY REQUIREMENTS FOR SUBSIDIZED AND UNSUBSIDIZED LOANS.—Any subsidized loan under this part may be made only to a student eligible to participate in programs under this title pursuant to section 484, and any unsubsidized loan under this part may be made only to such a student or the parent of a dependent undergraduate student.

"(2) NEEDS TESTING FOR SUBSIDIZED LOANS.—A subsidized loan under this part may be made only to a student who (in addition to meeting the requirements of paragraph (1)) demonstrates financial need for such loan (pursuant to part F of this title).

"(3) STUDENT ELIGIBILITY FOR UNSUBSIDIZED LOANS.—(A) Independent students shall be eligible to borrow unsubsidized loans under this part in amounts specified in subsection (c)(2). In addition, undergraduate dependent students shall be eligible to borrow funds under this section if the financial aid administrator determines, after review of the financial aid information submitted by the student and considering the debt burden of the student, that exceptional circumstances will likely preclude the student's parents from borrowing under this part. If the financial aid administrator makes such a determination, appropriate documentation of such determination shall be maintained in the institution's records to support such determination. No student shall be eligible to borrow unsubsidized loans under this part until such student has obtained a certificate of graduation from a school providing secondary education, or the recognized equivalent of such certificate.

"(B) Unsubsidized loans may not be borrowed under this part by any undergraduate student who is enrolled at any institution during any fiscal year if the cohort default rate for such institution, for the most recent fiscal year for which such rates are available, equals or exceeds 30 percent. The Secretary shall notify institutions to which such restriction applies annually, and specify the fiscal year covered by the restriction. The Secretary shall afford any institution to which such restriction applies an opportunity to present evidence contesting the accuracy of the calculation of the cohort default rate for such institution.

"(4) PARENT ELIGIBILITY FOR UNSUBSIDIZED LOANS.—Parents of a dependent student shall be eligible to borrow unsubsidized loans under this part in any amount, subject to subsection (c)(1).

"(b) SUBSIDIZED LOAN AMOUNTS.—

"(1) DETERMINATION BASED ON COST OF ATTENDANCE.—The amount of all subsidized loans for each student for each academic year made from loan funds paid pursuant to agreements under this part may not exceed the cost of attendance at the institu-

tion of higher education for that year minus the aggregate of—

"(A) any financial assistance received by the student borrower under parts A and C of this title, and any other provision of Federal law;

"(B) any other scholarship, grant, and loan assistance received by the student borrower; and

"(C) the expected family contribution.

"(2) ANNUAL LIMITS.—No student may borrow under this part an amount of subsidized loans in any academic year or its equivalent (as determined under regulations of the Secretary) in excess of—

"(A) In the case of a student at an eligible institution who has not successfully completed the first and second year of a program of undergraduate education—

"(i) $6,500, if such student is carrying at least the normal full-time academic workload (as defined in regulations of the Secretary);

"(ii) $4,875, if such student is carrying three-quarters of the normal full-time

academic workload (as defined in regulations of the Secretary); and

"(iii) $3,250, if such student is carrying at least one-half of the normal full-time academic workload (as defined in regulations of the Secretary);

"(B) In the case of a student at an eligible institution who has successfully completed such first and second year but has not successfully completed the remainder of a program of undergraduate study—

"(i) $8,000, if such student is carrying at least the normal full-time academic workload (as defined in regulations of the Secretary);

"(ii) $6,000, if such student is carrying at least three-quarters of the normal full-time academic workload (as defined in regulations of the Secretary); and

"(iii) $4,000, if such student is carrying at least one-half of the normal full-time academic workload (as defined in regulations of the Secretary).

"(C) In the case of a graduate or professional student (as defined in regulations of the Secretary) at an eligible institution—

"(i) $13,000, if such student is carrying at least the normal full-time academic workload (as defined in regulations of the Secretary); and

"(ii) $6,500, if such student is carrying at least one-half of the normal full-time academic workload (as defined in regulations of the Secretary); and

except in cases where the Secretary determines, pursuant to regulations, that a higher amount is warranted in order to carry out the purpose of this part with respect to students engaged in specialized training requiring exceptionally high costs of education.

"(3) AGGREGATE LIMITS.—No student may borrow under this part an aggregate principal amount of subsidized loans in excess of—

"(A) $38,500, in the case of any student who has not successfully completed a program of undergraduate education (excluding unsubsidized loans); or

"(B) $98,500, in the case of any graduate or professional student (as defined by regulations of the Secretary and including any loans under this part made to such student before the student became a graduate or professional student, but excluding unsubsidized loans).

"(c) UNSUBSIDIZED LOAN AMOUNTS.—

"(1) DETERMINATION BASED ON COST OF ATTENDANCE.—The amount of all unsubsidized loans for any student (whether obtained by the student or a parent, or both) for each academic year made from loan funds paid pursuant to agreements under this part may not exceed the cost of attendance at the institution of higher education for that year minus the aggregate of—

"(A) any financial assistance received by the student borrower under parts A and C of this title, and any other provision of Federal law, including any subsidized loan under this part; and

"(B) any other scholarship, grant, and loan assistance received by the student borrower.

"(2) LIMITS ON UNSUBSIDIZED LOANS TO STUDENTS.—

"(A) ANNUAL LIMITS.—No student may borrow under this part an amount of

unsubsidized loans in any academic year or its equivalent (as determined under regulations of the Secretary) in excess of—

"(i) $4,000, in the case of a student who has not successfully completed the first and second year of a program of undergraduate education, except as provided in subparagraph (C);

"(ii) $6,000, in the case of a student who has successfully completed such first and second year but who has not successfully completed the remainder of a program of undergraduate education; or

"(iii) $10,000, in the case of a graduate or professional student (as defined in regulations of the Secretary);

except in cases where the Secretary determines, pursuant to regulations, that a higher amount is warranted in order to carry out the purpose of this part with respect to students engaged in specialized training requiring exceptionally high costs of education.

"(B) AGGREGATE LIMITS.—No student may borrow under this part an aggregate principal amount of unsubsidized loans in excess of—

"(i) $28,000, in the case of any student who has not successfully completed a program of undergraduate education (excluding subsidized loans); or

"(ii) $78,000, in the case of any graduate or professional student (as defined by regulations of the Secretary and including any loans under this part made to such student before the student became a graduate or professional student, but excluding subsidized loans).

"(c) SPECIAL RULE FOR FIRST-YEAR PART-TIME STUDENTS.—In the case of a student who has not successfully completed the first year of a program of undergraduate education and who is not enrolled in a program that is at least one academic year in length, as determined in accordance with regulations prescribed by the Secretary, the maximum amount of unsubsidized loans a student may borrow in any academic year or its equivalent shall be—

"(1) $2,500 for a student who is determined, in accordance with such regulations, to be enrolled in a program whose length is at least ⅔ of an academic year;

"(2) $1,500 for a student who is determined, in accordance with such regulations, to be enrolled in a program whose length is less than ⅔, but at least ⅓, of an academic year; and

"(3) zero for a student who is determined, in accordance with such regulations, to be enrolled in a program whose length is less than ⅓ of an academic year.

"(d) DETERMINATIONS BASED ON COST OF ATTENDANCE.—Determinations under subsections (b)(1) and (e)(1) shall be made by the institution of higher education in accordance with the provisions of part F of this title.

"(e) ANNUAL LIMIT DETERMINATIONS.—The annual limits contained in this section shall not be deemed to be exceeded by a line of credit under which actual payments to the borrower will not be made in any year in excess of the annual limit.

"SEC. 454. TERMS OF LOANS.

"(a) REQUIREMENTS FOR BOTH SUBSIDIZED AND UNSUBSIDIZED LOANS.—A loan may be made with funds paid under this part only if—

"(1) made to a student, or the parent of a student, who (A) is an eligible student under section 484; (B) has agreed to notify promptly the Secretary concerning any change of address; and (C) is

carrying at least one-half the normal full-time academic workload for the course of study the student is pursuing (as determined by the institution); and

"(2) evidenced by a note or other written agreement which—

"(A) is made without security and without endorsement, except that if the borrower is a minor and such note or other written agreement executed by the borrower would not under the applicable law, create a binding obligation, endorsement may be required;

"(B) provides that periodic installments of principal need to be paid, but interest shall accrue and be paid, during any period—

"(i) during which the borrower (I) is pursuing a full-time course of study at an eligible institution, (II) is pursuing at least a half-time course of study (as determined by such institution) during an enrollment period for which the student has obtained a loan under this part, or (III) is pursuing a course of study pursuant to a graduate fellowship program approved by the Secretary, or pursuant to a rehabilitation training program for disabled individuals

approved by the Secretary except that no borrower shall be eligible for a deferment under this clause or any subsidized loan made under this part, while serving in a medical internship or residency program;

"(ii) not in excess of 24 months, at the request of the borrower, during which the borrower is seeking and unable to find full-time employment; or

"(iii) not in excess of 36 months for any reason which the lender deems will cause economic hardship for the borrower, pursuant to regulation by the Secretary,

and that any such period shall not be included in determining the 10-year period provided in subparagraph (B), except that only the provisions of clauses (i), and (ii) of this subparagraph shall be available in the case of a borrower who is a parent of a qualified student under section 453(a);

"(C) entitles the borrower to accelerate without penalty repayment of the whole or any part of the loan;

"(D)(i) contains a notice of the system, of disclosure of information concerning such loan

to credit bureau organizations under section 430A, and

"(ii) provides that the Secretary on request of the borrower will provide information on the repayment status of the note to such organizations; and

"(E) contains such other terms and conditions, consistent with the provisions of this part and with the regulations issued by the Secretary pursuant to this part, as may be agreed upon by the parties to such loan;

"(3) the funds borrowed are disbursed to the student by check or other means that is payable to and requires the endorsement or other certification by such student, except nothing in this part shall be interpreted to allow the Secretary to require checks to be made copayable to the institution and the borrower or to prohibit the disbursement of loan proceeds by means other than by check; and

"(4) the funds borrowed are disbursed by the institution in accordance with a schedule that is consistent with subsection (d).

"(b) ADDITIONAL TERMS FOR SUBSIDIZED LOANS.—The note or other written agreement for any subsidized loan shall—

"(1) provide for repayment (except as provided in subsection (e)) of the principal amount of the loan in installments over a period of not less than 5 years (unless sooner repaid or unless the student during the 6 months preceding the start of the repayment period, specifically requests that repayment be made over a shorter period) nor more than 10 years, beginning 6 months after the month in which the student ceases to carry at an institution of higher education one-half the normal full-time academic workload as determined by the institution; except—

"(A) as provided in subsection (a)(2)(B);

"(B) that the note or other written instrument may contain such reasonable provisions relating to repayment in the event of default in the payment of interest or in the payment of the cost of insurance premiums, or other default by the borrower, as may be authorized by regulations of the Secretary in effect at the time the loan is made; and

"(C) that the lender and the student, after the student ceases to carry at an eligible institution at least one-half the normal full-time academic workload as determined by the institution, may agree to a repayment schedule

which begins earlier, or is of shorter duration, than required by this subparagraph, but in the event a borrower has requested and obtained the repayment period of less than 5 years, the borrower may at any time prior to the total repayment of the loan, have the repayment period extended so that the total repayment period is not less than 5 years; and

"(2) provide for interest on the unpaid principal balance of the loan at a rate of 8 percent per year, which interest shall be payable in installments over the period of the loan except that, if provided in the note or other written agreement, any interest payable by the student may be deferred until not later than the date upon which repayment of the first installment of principal falls due, in which case interest accrued during that period may be added on that date to the principal.

"(c) ADDITIONAL TERMS FOR UNSUBSIDIZED LOANS.—The note or other written agreement for any unsubsidized loan shall—

"(1) provide for repayment (except as provided in subsection (e)) of the principal amount of the loan in installments over a period of not less than 5 years (unless sooner repaid or unless the borrower

during the 6 months preceding the start of the repayment period, specifically requests that repayment be made over a shorter period) nor more than 10 years, beginning not later than 60 days after the date such loan is disbursed, or, if the loan is disbursed in multiple installments, not later than 60 days after the disbursement of the last such installment; except—

"(A) as provided in subsection (a)(2)(B);

"(B) that the note or other written instrument may contain such reasonable provisions relating to repayment in the event of default in the payment of interest or in the payment of the cost of insurance premiums, or other default by the borrower, as may be authorized by regulations of the Secretary in effect at the time the loan is made; and

"(C) that the lender and the borrower, after the student ceases to carry at an eligible institution at least one-half the normal full-time academic workload as determined by the institution, may agree to a repayment schedule which begins earlier, or is of shorter duration, than required by this subparagraph, but in the event a borrower has requested and obtained

the repayment period of less than 5 years, the borrower may at any time prior to the total repayment of the loan, have the repayment period extended so that the total repayment period is not less than 5 years;

"(2) provide for interest on the unpaid principal balance of the loan at the rate most recently determined under subsection (f)(2) at the time the loan is made, which interest shall be payable in installments over the period of the loan except that, if provided in the note or other written agreement, any interest payable by the student may be deferred until not later than the date upon which repayment of the first installment of principal falls due, in which case interest accrued during that period may be added on that date to the principal.

"(d) REQUIREMENTS FOR DISBURSEMENT OF STUDENT LOANS.—

"(1) MULTIPLE DISBURSEMENT REQUIRED.—

"(A) TWO DISBURSEMENTS REQUIRED.—The proceeds of any loan made under this part that is made for any period of enrollment shall be disbursed in 2 or more installments, none of which exceeds one-half of the loan.

"(B) MINIMUM INTERVAL REQUIRED.—The interval between the first and second such installments shall be not less than one-half of such period of enrollment, except as necessary to permit the second installment to be disbursed at the beginning of the second semester, quarter, or similar division of such period of enrollment.

"(2) METHOD OF MULTIPLE DISBURSEMENT.—Disbursements under paragraph (1) shall be made in accordance with a schedule determined by the institution that complies with the requirements of this section.

"(3) WITHHOLDING OF SECOND DISBURSEMENT.—

"(A) WITHDRAWING STUDENTS.—An institution or designated lending agent that is informed by the borrower or the institution that the borrower has ceased to be enrolled before the disbursement of the second or any succeeding installment shall withhold such disbursement. Any disbursement which is so withheld shall be credited to the borrower's loan and treated as a prepayment thereon.

"(B) STUDENTS RECEIVING OVERAWARDS.—If the sum of a disbursement for any student and the other financial aid obtained by such student exceeds the amount of assistance for which the student is eligible under this title, the institution such student is attending shall withhold and return the portion (or all) of such installment that exceeds such eligible amount. Any portion (or all) of a disbursement installment which is so returned shall be credited to the borrower's loan and treated as a prepayment thereon.

"(5) SPECIAL RULES FOR MULTIPLE DISBURSEMENT.—For the purpose of this subsection—

"(A) all loans issued for the same period of enrollment shall be considered as a single loan; and

"(B) the requirements of such subsection shall not apply in the case of a loan made to a student to cover the cost of attendance at an eligible institution outside the United States.

"(e) SPECIFIC REPAYMENT RULES.—

"(1) MINIMUM AMOUNTS TO BE REPAID ANNUALLY.—The total of the payments by a borrower during any year of any repayment period with re-

spect to the aggregate amount of all subsidized and unsubsidized loans to that borrower which are paid from loan funds paid pursuant to agreements under this part shall not, unless the borrower and the Secretary otherwise agree, be less than $600 or the balance of all such loans (together with interest thereon), whichever amount is less, except that in the case of husband and wife, both of whom have such loans outstanding, the total of the combined payments for such a couple during any year shall not be less than $600 or the balance of all such loans, whichever is less.

"(2) GRADUATED AND INCOME CONTINGENT REPAYMENT SCHEDULES.—If a borrower so requests, the repayment of a loan under this part shall be made in accordance with a graduated or income contingent repayment schedule established by the Secretary by regulation. In order to carry out the provisions of this paragraph, the Secretary and the borrower may agree to increase the repayment period described in subsection (b)(1) or (c)(1) of this section, but in no event may the repayment period be extended beyond 20 years.

"(3) NOTICE.—The Secretary shall notify the student borrower of a loan under this part at the beginning of the repayment period of the availability of the flexible repayment program.

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"(f) INTEREST RATES.—

(1) ORDER TO ESTABLISH RATES ON UNSUBSIDIZED LOANS.—The Secretary shall, by order published in the Federal Register, establish the interest rates for unsubsidized loans made under this part. Such order shall be published not later than January 2, and shall be effective with respect to loans made during the one-year period beginning on the July 1 following such publication. The Secretary's order shall not be subject to judicial review.

"(2) INTEREST RATE FOR UNSUBSIDIZED LOANS.—The order prescribed under paragraph (1) shall establish an interest rate for subsidized loans made after the effective date of such order and before the effective date of a subsequent order. Such rate shall be equal to—

"(A) the bond equivalent rate of 52-week Treasury bills auctioned at the final auction held prior to the date such order is prescribed; plus

"(B) 3.25 percent.

"(3) REPORT ON INTEREST RATE ON UNSUBSIDIZED LOANS.—The Secretary shall submit

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to the Congress a report for any fiscal year for which the interest rate for unsubsidized loans established under paragraph (2) subsection is not sufficient to recover for the Government—

"(A) the cost to the Government of obtaining the funds for such loans under section 457;

"(B) the costs to the Government of obtaining collection services for such loans under section 456; and

"(C) the costs to the Government of administering this part with respect to such loans.

"(D) the costs to the Government that result from any defaults on such loans by the borrowers.

"(4) REPORT ON INTEREST RATE ON SUBSIDIZED LOANS.—The Secretary shall submit to the Congress a report for any fiscal year for which the interest rate for subsidized loans established under subsection (c)(2) is not sufficient to recover for the Government—

"(A) the cost to the Government of obtaining the funds for such loans under section 457;

"(B) the costs to the Government of obtaining collection services for such loans under section 456; and

"(C) the costs to the Government of administering this part with respect to such loans.

"SEC. 455. CONSOLIDATION LOANS.

"(a) AGREEMENTS FOR PROVISION OF LOANS.—

(1) AGREEMENT REQUIRED FOR PROVISION OF LOANS.—For the purpose of providing loans to eligible borrowers for consolidation of their obligations with respect to eligible student loans, the Secretary shall enter into agreements in accordance with subsection (b).

"(2) PROVISION OF FUNDS TO CONSOLIDATION AGENTS.—The Secretary shall, by regulation, provide for the distribution of funds obtained pursuant to section 457 through consolidation agents to eligible borrowers under this section. Such regulations shall, to the extent practicable, reflect the procedures used to distribute funds to institutions under section 452.

"(3) DEFINITION OF ELIGIBLE BORROWER.—(A) For the purpose of this section, the term 'eligible borrower' means a borrower who, at the time of application for a consolidation loan—

"(i) has an outstanding indebtedness on eligible student loans, at the time of application

for a consolidation loan, of not less than $5,000; and

"(ii) is in repayment status, or in a grace period preceding repayment, and is not delinquent with respect to any required payment on such indebtedness by more than 90 days.

"(B) An individual's status as an eligible borrower under this section terminates upon receipt of a consolidation loan under this section except with respect to eligible student loans received after the date of receipt of the consolidation loan. Loans made under this section shall, to the extent used to discharge loans made under this title, be counted against the applicable limitations on aggregate indebtedness contained in sections 425(a), 428(b)(1)(B), 428A(b)(2), 454, and 464(a)(2). Nothing in this subparagraph shall be interpreted to authorize the Secretary to require agents for consolidation loans to receive, to maintain, or to make reports with respect to preexisting records relating to any eligible student loan (as defined under paragraph (4)) discharged by a borrower in receiving a consolidation loan.

"(4) DEFINITION OF ELIGIBLE STUDENT LOANS.—For the purpose of paragraph (1), the term

'eligible student loans' means any of the following loans, if at least one loan is a loan described in subparagraph (A) of this paragraph:

"(A) loans made under this part except for loans made to parents;

"(B) loans made, insured, or guaranteed under part B except for loans made to parent borrowers under section 428B, including loans made to parent borrowers under section 428B as in effect prior to the enactment of the Higher Education Amendments of 1986;

"(C) loans made under part E of this title; or

"(D) loans made under subpart II of part C of title VII of the Public Health Service Act.

"(b) AGREEMENTS WITH AGENT.—Any agent selected by the Secretary to operate a program of transmitting consolidation loans from the Secretary to eligible borrowers under this section shall enter into an agreement with the Secretary which provides—

"(1) that the agent will provide a consolidation loan to an eligible borrower (on request of that borrower) only if the borrower certifies that the borrower has no other application pending for a loan under this section;

"(2) that each consolidation loan will bear interest, and be subject to repayment, in accordance with subsection (c);

"(3) that each consolidation loan will be made, notwithstanding any other provision of this part limiting the annual or aggregate principal amount for all insured loans made to a borrower, in an amount (A) which is not less than the minimum amount required for eligibility of the borrower under subsection (a)(3), and (B) which is equal to the sum of the unpaid principal and accrued unpaid interest and late charges of all eligible student loans received by the eligible borrower which are selected by the borrower for consolidation;

"(4) that the proceeds of each consolidation loan will be paid to the holder or holders of the loans so selected to discharge the liability on such loans;

"(5) that a consolidation loan will not be made unless the agent has determined to its satisfaction, in accordance with reasonable and prudent business practices, for each loan being consolidated—

"(A) that the loan is a legal, valid, and binding obligation of the borrower;

"(B) that each such loan was made and serviced in compliance with applicable laws and regulations; and

"(C) in the case of loans under part B, that the insurance on such loan is in full force and effect;

"(6) the reporting requirements of the Secretary on the agent and an identification of the office of the Department of Education which will process claims and perform other related administrative functions;

"(7) the alternative repayment terms which will be offered to borrowers; and

"(8) such other terms and conditions as the Secretary may specifically require of the agent to carry out this section.

"(c) TERMS AND CONDITIONS OF LOANS.—A consolidation loan made pursuant to this section shall be made only to an eligible borrower who has agreed to notify the Secretary promptly concerning any change of address. The consolidation loan shall be evidenced by a note or other written agreement which—

"(1) is made without security and without endorsement, except that if the borrower is a minor and such note or other written agreement executed

by him or her would not, under applicable law, create a binding obligation, endorsement may be required;

"(2) provides for the payment of interest and the repayment of principal in accordance with subsection (c) of this section;

"(3) provides that periodic installments of principal need not be paid, but interest shall accrue and be paid by the Secretary, during any period for which the borrower would be eligible for a deferral under section 454(a)(2)(B), and that any such period shall not be included in determining the repayment period pursuant to subsection (c)(2) of this section;

"(4) entitles the borrower to accelerate without penalty repayment of the whole or any part of the loan; and

"(5)(A) contains a notice of the system of disclosure concerning such loan to credit bureau organizations under section 430A, and

"(B) provides that the lender on request of the borrower will provide information on the repayment status of the note to such organizations.

"(d) PAYMENT OF PRINCIPAL AND INTEREST.—

"(1) INTEREST RATES.—(A) Consolidation loans made under this section shall bear interest at rates determined under subparagraph (B) or (C).

"(B) Except as provided in subparagraph (C), a consolidation loan shall bear interest at an annual rate on the unpaid principal balance of the loan which is equal to the weighted average of the interest rates on the loans consolidated, rounded to the nearest whole percent.

"(C) A consolidation loan shall bear interest at an annual rate on the unpaid principal balance of the loan equal to not less than 8 percent.

"(2) REPAYMENT SCHEDULES.—(A) Notwithstanding any other provision of this part, the Secretary shall establish repayment terms as will promote the objectives of this section, which shall include the establishment of graduated and income contingent repayment schedules. Such repayment terms shall require that if the sum of the consolidation loan and the amount outstanding on other student loans to the individual—

"(i) is equal to or greater than $10,000 but less than $20,000, then such consolidation loan shall be repaid in not more than 15 years;

"(ii) is equal to or greater than $20,000 but less than $40,000, then such consolidation loan shall be repaid in not more than 20 years;

"(iii) is equal to or greater than $40,000 but less than $60,000, then such consolidation loan shall be repaid in not more than 25 years;

"(iv) is equal to or greater than $60,000, then such consolidation loan shall be repaid in not more than 30 years.

"(B) Unless a consolidation loan under subparagraph (A)(ii) will be used to discharge at least $5,000 of loans made under this part, such loan shall be repaid in accordance with subparagraph (A)(i).

"(C) The amount outstanding on other student loans which may be counted for the purpose of subparagraph (A) may not exceed the amount of the consolidation loan.

"(3) ADDITIONAL REPAYMENT REQUIREMENTS.—Notwithstanding paragraph (2), the Secretary may, with respect to repayment on the loan when the amount of a monthly or other similar payment on the loan is not a multiple of $5, round the payment to the next highest whole dollar amount that is a multiple of $5.

"(4) COMMENCEMENT OF REPAYMENT.—Repayment of a consolidation loan shall commence within 60 days after all holders have, pursuant to subsection (b)(1)(D), discharged the liability of the borrower on the loans selected for consolidation.

"SEC. 456. ADMINISTRATIVE PROVISIONS.

"(a) IN GENERAL.—In carrying out the provisions of this part, the Secretary is authorized—

"(1) to consent to the modification, with respect to rate of interest, time of payment of any installment of principal and interest or any portion thereof, or any other provision of any note evidencing a loan which has been made under this part;

"(2) to enforce, pay, compromise, waive, or release any right, title, claim, lien, or demand, however acquired, including any equity or any right of redemption;

"(3) to conduct litigation in accordance with the provisions of section 432(a)(2);

"(4) encourage either directly or by way of contract or other arrangement the participation of institutions of higher education in the program authorized by this part; and

"(5) to enter into competitive contracts or other arrangements with State agencies, guaranty agen-

cies, nonprofit organizations, institutions of higher education, and with collection and servicing agencies, for servicing and collection of loans under this part.

"(b) LOAN COLLECTION FUNCTIONS UNDER COMPETITIVE PROCUREMENT CONTRACTS.—The Secretary, by one or more contracts made in accordance with Federal laws concerning Government procurement, shall provide for—

"(1) the collection of principal and interest of student loans made under this part;

"(2) the establishment and operation of a central data system for the maintenance of records on all loans made pursuant to this part;

"(3) programs for default prevention; and

"(4) such other programs as the Secretary determines are necessary to assure the success of the student loan program authorized by this part.

"(c) LOAN CONSOLIDATION FUNCTIONS.—The Secretary, by one or more contracts made in accordance with Federal laws regulating Government procurement, shall provide for loan consolidation in accordance with section 455.

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"SEC. 457. SOURCE OF FUNDS FOR FEDERAL DIRECT LOANS.

"(a) OBLIGATIONS AUTHORIZED.—(1) The Secretary shall, not later than April 1 of each fiscal year, issue and have outstanding at any one time notes, debentures, bonds, or other obligations in such amounts as shall be necessary to carry out functions under this part, except that the Secretary shall not issue any such obligation without the prior concurrence of the Secretary of the Treasury as to the terms and conditions of such obligations. The Secretary of the Treasury may direct that any such issuance by the Secretary be sold to the Department of Treasury for its own account or to the Federal Financing Bank.

"(2) The Secretary of the Treasury is authorized and directed to purchase any obligations issued under this section, and for that purpose, the Secretary of the Treasury is authorized to use as a public debt transaction the proceeds for the sale of any securities hereafter issued under the Second Liberty Bond Act, and the purposes for which securities may be issued under the Second Liberty Bond Act are extended to include such purchases. Each purchase of obligations by the Secretary of the Treasury under this section shall be upon such terms and conditions as to yield a return at a rate not less than a rate determined by the Secretary of the Treasury, taking into consideration the current average yield on outstanding mar-

ketable obligations of the United States of comparable maturity. Interest due on obligations of the Secretary held by the Treasury may be deferred, at the discretion of the Secretary, but any such deferred interest shall bear interest at the rate specified in this section. The Secretary of the Treasury may sell, upon such terms and conditions and at such price or prices as he shall determine, any of the obligations acquired by him under this section. All redemptions purchases, and sales by the Secretary of the Treasury of such obligations under this section shall be treated as public debt transactions of the United States.

"(b) GUARANTEE.—All obligations of the Secretary issued under this section shall be fully and unconditionally guaranteed as to principal and interest and shall constitute general obligations of the United States, backed by the full faith and credit of the Government of the United States of America. Such guarantee shall be expressed on the face of all such obligations.

"(c) SUBSIDY PROVISIONS.—(1) Obligations of the Secretary issued pursuant to this section shall be lawful investments, and may be accepted as security for all fiduciary, trust, and public funds the investment or deposit of which shall be under the authority or control of the United States or any officer or officers thereof. All stock and obligations issued by the Secretary pursuant to this

section shall be deemed to be exempt securities within the meaning of laws administered by the Securities and Exchange Commission to the same extent as securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States.

"(2) In order that the Secretary may be supplied with such forms of notes, debentures, bonds, or other such obligations as it may need for issuance under this section, the Secretary of the Treasury is authorized to prepare such forms as shall be suitable and approved by the Secretary, to be held in the Treasury subject to delivery, upon order of the Secretary. The engraved plates, dies, bed pieces, and so forth, executed in connection therewith shall remain in the custody of the Secretary of the Treasury. The Secretary shall reimburse the Secretary of the Treasury for any expenses incurred in the preparation, custody, and delivery of such notes, debentures, bonds, or other obligations.

"(3) All moneys of the Secretary not otherwise employed may be—

"(A) deposited with the Treasury of the United States subject to withdrawal by the Secretary, by check drawn on the Treasury of the United States by a Treasury disbursing officer, or

"(B) with the approval of the Secretary of the Treasury, deposited in any Federal Reserve bank, or

"(C) with the approval of the Secretary of the Treasury, and by authorization of the Secretary, used in the purchase for redemption and retirement of any notes, debentures, bonds, or other obligations issued by the Secretary.

"SEC. 458. DEFINITIONS.

"As used in this part—

"(1) the term 'guaranty agency' has the same meaning given that term by section 435(j); and

"(2) the term 'institution of higher education' means any eligible institution described in section 481 which has demonstrated administrative capacity to carry out the provisions of this part.".

SEC. 452. AMENDMENT TO WIND-DOWN THE STAFFORD STUDENT LOAN PROGRAM.

Section 428(a)(5) of the Act is amended to read as follows:

"(5) DURATION OF AUTHORITY.—The period referred to in paragraph (1)(B) of this subsection shall begin on the date of enactment of this Act and end at the close of June 30, 1996.".

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SEC. 453. ADMINISTRATIVE EXPENSES.

Part G of title IV of the Act is amended by adding at the end the following new section:

"AUTHORIZATION OF APPROPRIATIONS FOR ADMINISTRATIVE EXPENSES

"SEC. 492. There are authorized to be appropriated such sums as may be necessary for fiscal year 1992 and for each succeeding fiscal year thereafter for administrative expenses necessary for carrying out this title, including expenses for staff personnel and compliance activities.".

Note: Since the draft of the House bill was distributed, the Subcommittee has technically amended certain portions of the bill to clarify certain provisions. Among these technical amendments are the following:

1. In section 452, the technical amendment clarifies that for 1996-97 academic year, those institutions desiring to participate in the direct loan program can do so.

2. In section 452, the technical amendment permits institutions or consortia of institutions to use a designated lending agent to carry out their responsibilities for originating direct loans.

3. In section 454, the technical amendment clarifies that the Secretary shall pay the in-school interest and interest during deferment periods for subsidized loans, and also clarifies that borrowers must pay in-school and deferment period interest for unsubsidized loans.

4. In section 454, the technical amendment conforms the unsubsidized loan interest rate to the current SLS and PLUS rates by capping the rate at 12 percent.

ROBERT E. ANDREWS
FIRST DISTRICT, NEW JERSEY

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SYNOPSIS OF HOUSE COMMITTEE PRINT
September 27, 1991

The Committee Print for the Reauthorization of the Higher Education Act, Part D of Title IV, would phase in the replacement of the Stafford, Supplemental Student Loan (SLS), Parent Loans for Undergraduate Students (PLUS) and Income Contingent Demonstration Loans with a program of direct Federal educational lending for all families. Beginning July 1, 1994, 500 schools will be eligible to participate in the program. An additional 1,000 schools will be added for the 1995-96 academic year, and in 1996-97 all institutions will be able to participate.

The bill has a number of important provisions which, in addition to being less costly to taxpayers, will improve benefits for students with financial need. Additionally, it will expand loan eligibility for middle income students and parents and simplify the application process for students and institutions.

Like Guaranteed Student Loans (GSLs), direct loans will be funded as an entitlement under the mandatory part of the budget. As in the GSL system, there will be no limit on the amount of capital that will be available. Capital availability will be determined by student and parent eligibility.

Student eligibility for subsidized direct loans will be based on financial need and annual loan limits will be increased to the following levels:

$6,500 for first year students
$8,000 for the balance of an undergraduate degree
$13,000 for graduate and professional students

Perkins loan revolving funds will become institutional endowments to fund additional grants for students.

Student eligibility criteria for direct loans will be similar to the current SLS program.

Parents will continue to be eligible for direct PLUS loans without a financial needs test and the amount borrowed will be increased from $4,000 to the cost of education minus any financial aid received by the student.

Direct loans will be offered at interest rates similar to the current GSL program, except that student interest rates will not exceed 8% in the subsidized program. (Under GSL, the rate increases from 8% to 10% in the fifth year of repayment). Neither a student origination fee (currently 5%) nor an insurance premium (currently up to 3%) will be charged.

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The Secretary of Education will be required to offer students income-contingent, graduated and conventional repayment plans.

Loan consolidation with direct lending authority will be available to students who have Stafford, Perkins or HEAL (health education) Loans and also receive direct loans.

Parent loan interest rates will continue at the existing PLUS program level. Interest income over cost of funds will be used, in part, to both help offset administrative costs and cover any defaults in the program.

The direct loan program will be financed through the sale of government securities by the Secretary of the Treasury and counted in the budget under the provisions of credit reform.

The Secretary of Education will receive the proceeds from Treasury sales and authorize the funds to eligible institutions of postsecondary education.

On behalf of the government, institutions will determine student and parent eligibility, prepare necessary promissory notes and allocate funds to students following procedures similar to those used in the Perkins Loan Program.

Each institution will transmit signed promissory notes to its ED contractors which will be responsible for servicing and collecting loans including the use of IRS offsets on defaulters.

The Secretary of Education will operate the servicing aspects of the program through competitive, private sector contracts, including a contract for management of the national direct loan data system, servicing, collection, and loan consolidation.

Institutions will be provided a $20 per loan administrative fee each year.

To ensure adequate administrative support for ED, student aid administrative costs will be mandated via line items in appropriation bills.

Like GSLs, direct loans will be exempt from the Truth in Lending Act.

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ROBERT E. ANDREWS
FIRST DISTRICT, NEW JERSEY

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September 24, 1991

RE: DIRECT LOANS

Dear Colleague:

A number of people have requested background material on some of the inaccurate and misleading information recently presented by opponents of direct lending. Documents circulated by several guarantee agencies and the Student Loan Marking Association have raised a number of questions. Most take their lead from Education Secretary Alexander's June 28, 1991 letter to House Education and Labor Committee Chairman Bill Ford.

It is understandable that the entities that presently benefit from the Federal subsidies in the Guaranteed Student Loan Program (GSL) would object to a proposal that would re-target billions of dollars from them to students and their families as well as simplify the student loan process.

The savings of direct federal lending over guaranteed lending are real and significant. This has been confirmed by responsible analysis in the Education Department, CBO and the GAO. The estimates may be refined, but as even one guarantee agency head recently wrote "...I am willing to concede for now that some savings would accrue."

Direct lending would enable the Federal government to leverage private sector dollars by paying wholesale prices for its student loan capital rather than the retail rates now paid for GSL capital.

Some have argued that simplifying the delivery of loans to students would make direct lending worth doing even if no savings resulted. However, expected savings of approximately $1.4 billion in the first year and $6.6 billion over four years are not unreasonable. These savings could be directed to even greater numbers of eligible students and their families.

While the February 1991 Kidder, Peabody & Co. report that reviewed the ED projections raised minor questions about the Department's estimating procedures, the bottom line was that "... We believe that it is not unreasonable to project that ED can realize 10% to 15% present value savings over the life of the loans thorough such a program (direct loans)..." Further, Kidder, Peabody stated that "...ED professionals working on this project are highly competent, and ... a significant amount of effort was devoted toward the preparation of these projections... (A)ll of the variables we believe are relevant to a comparison of a direct loan program to the current GSL program seem to have been accurately incorporated in ED's projections...."

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To those of us who have studied direct loans, it is curious that the Sallie Mae document on costs indicates that such a program could result in revenue losses at the state and Federal levels. Our analysis indicates that lenders interested in making loans would no doubt invest in other areas and the so called revenue losses would be restored. There may be some modest loss, however, since a recent ED study indicates that GSL loans are more profitable than home mortgages and car loans.

Assuming, however, that the revenue loss estimates are correct on this point, the $140 million Federal revenue loss estimated would suggest profits of about $400 million for the program. These profits would occur after expenses, including seven figure compensation packages for Sallie Mae CEOs and six figure salaries for non-profit guarantors.

Since civil servants at Treasury can readily handle all of the financing aspects of direct loans, the need for more highly compensated personnel will be diminished.

On June 28, 1991, Secretary Alexander sent a letter to Chairman Ford listing three "...issues which must be examined for any direct loan program." In a subsequent August 23, 1991 letter to its network, the United Student Aid Funds stated that "Secretary Alexander has identified with exceptional clarity and forthrightness the weaknesses in the proposal for direct loans. He effectively counters the specious claims of significant savings widely proclaimed by [direct loan] proponents."

Following are Alexander's alleged "weaknesses" of direct loans, and my responses:

1. Increased Federal Debt

"The direct loan approach envisions capital raised by the Federal Government. Budget scoring under the Credit Reform Act would not "count" this capital as budget authority or outlays, but this borrowing would still have a very direct negative impact. It adds directly to the national debt. At current volume projections, roughly $10 billion (the unsubsidized portion of loan volume) would have to be borrowed by the Federal Government in the first year. Over a 20 year period, borrowing would be between $200 and $300 billion. Loan repayments would not be material for many years."

Notwithstanding the Secretary's concern, Credit Reform makes good sense to the economists---see the CBO Dec. 1989 study and others. As one might recall from Economics 101, loan guarantees have the same effect on the economy as direct loans. In fact, GSL loan guarantees are listed in the President's FY 92 budget as a 100% contingent liability of the Federal Government---the same as would be its responsibility for direct loans. Loan guarantees impact treasury bill rates virtually as much as direct borrowing and loan guarantee programs are more costly overall.

Opponents of direct lending have further attempted to confuse people by mixing the annual deficit with the national debt. The $10 billion dollars in loan volume each year would be added to the $4 trillion dollar national debt. If direct loan savings were not given to students, they could be used to reduce the annual deficit---something that really counts.

2. Risk to the Federal Government

"The current problems in the financial industry clearly demonstrate the importance of considering risk to the Government in any new policy venture. The Federal direct loan option would shift all loan risk to the Federal Government. Knowledgeable individuals may disagree on the extent to which the current reinsurance rules and lender guarantee agency due diligence requirements actually share risk, but there is no question that the Federal Government's risk is now less than 100%."

If the risk is now less than 100% for GSL, one wonders why President Bush considers GSL capital a 100% contingent liability of the Federal Government. If there is risk, it is due to mismanagement on the part of lenders and, for the most part, guarantee agencies. The current program is not structured to incur risk. The states do not appropriate money for defaults. If agency annual default triggers go into effect for part of a year, the cost is borne by laundered Federal dollars or student insurance premiums. If one is concerned about reducing Federal risk, then one needs to reduce the government's exposure to white collar crime offered by the current system. Direct loans reduce Federal risk by providing clear, simple lines of accountability. Government servicing contracts, with positive performance bonuses and direct government oversight, will further reduce risk. However, if policy makers believe there should be some form of risk sharing in direct loans, then they and their supporters should send such a proposal to Congress.

3. Management of the program

"The use of contractors for loan servicing and default collection does not in any way reduce the complexity or enormity of the Federal administrative tasks inherent in starting up a direct loan program while at the same time winding down the guaranteed program and managing that program for some considerable period into the future. This Department is not currently prepared for such tasks. Our management review of the administration of the loan programs has made that abundantly clear. My new management team needs time to put new systems and procedures in place."

This point would make sense if one looks only at the GSL program which is widely acknowledged as unmanageable. Perhaps that is why the report of the Senate Government Operations Committee, which Sen. Sam Nunn chairs, recommends that alternatives to the guarantee agency system by considered.

Naturally, the Education Department is "...not currently ready..." to manage direct loans. The program hasn't been enacted. However, with a July 1, 1994 start-up date and building from existing ED delivery systems that have been shown to work, surely direct loans can be effectively implemented under the leadership of a former governor and university president and a past president of the Xerox Corporation.

Institutions that have studied direct lending believe that it will ease institutional administration and serve students better. Administrative costs and possible liabilities for institutions may indeed be less under direct lending than under GSL, according to institutional representatives who have thought this program out with great care.

Financing for direct loans will be handled by Treasury the same way it raised capital for Sallie Mae until 1981. That system worked. Moreover, Sallie Mae still has $4.8 billion of Treasury acquired capital as an asset.

If a college, university or trade school can process a Pell Grant or GSL, it can handle direct loans. For the student as well as the institution, the application process would work much like the Pell Grant program. Students would sign promissory notes that the institution would forward to its servicing agent. The opportunity for error would be considerably less than that of the complicated GSL program and the simplicity of the operation would reduce overall institutional costs.

Indeed, direct loans promise a number of significant operational advantages to institutions:

---Fewer disgruntled students; fewer students unaware of who holds their loans; fewer students with multiple lenders;

---Elimination of complicated GSL overaward procedures;

---Elimination of the need to process thousands of checks made out to the institution and the student;

---Improved cash-flow;

---Elimination of financial aid transcripts;

---Elimination of multiple guarantee agency forms and rules.

The Education Department has done a good job of managing student loans with contractors for the Pell Grant and campus-based programs. Direct loans are in no way comparable to the old FISL guarantee program and the Department has developed considerable expertise in collections over the years. In fact, the current Deputy Assistant Secretary for Student Assistance recently indicated that ED can do a better job of collection on defaulted loans than guarantee agencies.

Some have asserted that direct loans would be open to fraud and abuse by institutions. One only has to look at the capers undertaken by some lenders and secondary markets in the current program to know that fraud and abuse in the existing loan system is not confined to a few schools. Without over 50 guarantee agencies, thousands of lenders, and secondary markets to oversee, the Department's efforts can be focused on contractors and schools. With clean lines of accountability and financing managed by Treasury, opportunities for fraud and abuse would be minimized.

Further, the reauthorization of the Higher Education Act will complete the task of removing unscrupulous schools from the student aid programs with changes in institutional eligibility requirements.

In addition to the Secretary's objections, listed above, an added argument against direct loans is that trade schools will use them to increase tuition. Whatever one's view about that, there can be no difference between GSL and direct loans on that point. The Administration has proposed increasing loan limits for the GSL program. If there is an incentive to increase tuition artificially it would be the same with either program.

Finally, some have predicted phase down problems with the guarantee program. Certainly, lenders will want their claims paid on outstanding loans and will, therefore, perform due diligence. Guarantee agencies will be supplied an administrative allowance based on outstanding loan volume to assist in the process. As the HEAF problem demonstrated, loan guarantees can be transferred. A shakedown among guarantee agencies is widely expected in the near future, even if the direct loan program is not enacted.

Ultimately, lenders participate in the GSL program because it is profitable. In the transition from GSL to direct loans, one must assume the same economic process would continue. It is hard to accept the usual "sky is falling" cry that we have heard so many times before from the advocates of traditional lenders. In any case, higher education does business with the lending industry in a variety of ways; one would hope that, during a transition, a spirit of cooperation would prevail from corporate boardrooms.

With a July 1, 1994 start date for direct lending and the phase in plan provided a smooth transition is possible.

Direct loans offer a wonderful opportunity to turn the corner on the 1980's decline in support for students and families. One would hope that the lending industry will recognize the social benefits of direct loans and offer their support while finding other investment opportunities and participating in the servicing and support functions of direct lending.

Sincerely,

Robert E. Andrews

ROBERT E. ANDREWS
Member of Congress

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THE PROPOSAL FOR DIRECT LOANS: AN UNEASY CASE

In its search for ways to distribute assistance to students at a lower cost to the federal government, Congress has indicated its willingness to seriously consider phasing out the existing Guaranteed Student Loan Program with a "direct" loan program. Under such a program, the current network of private capital providers -- primarily commercial banks, savings and loans, and credit unions, supported by both for-profit and non-profit secondary markets -- would be replaced by the U.S. Treasury which would raise capital for student loans. Instead of private lenders making loans to students and disbursing funds through the schools they attend, the federal government would, through a new and untried mechanism, disburse funds to schools, who would make loans to the students who qualify.

Three principal reasons have been cited by proponents of the direct loan concept as the rationale for scrapping the existing Guaranteed Student Loan Program (GSLP) and its 26-year history of success, in favor of an untested approach to providing education credit. First, it is said that the direct loan program will be less costly to the federal government than the GSLP; second, the direct loan program will be simpler to operate than the GSLP; and third, the direct loan program will provide schools with a more desirable degree of control over the loan process. Upon closer scrutiny, the direct loan program would not likely deliver on any of these claims. Instead, it promises to inject concerns and risks that are not inherent in the existing GSLP and reduce the level of service received by students, parents and schools. These concerns become apparent as one compares the direct loan approach with the existing GSLP on the basis of the factors of simplicity, reliability, allocation of burdens, quality and integrity, all of which tell us how good a program is.

Direct Loans Do Not Cost Less Than Guaranteed Student Loans, In Fact, They Cost More

The question of federal cost savings, which is perhaps the paramount issue for proponents of direct loans, while not entirely divorced from qualitative issues, has been the subject of separate quantitative analyses which tell us how much it costs to deliver loans to students which are funded directly by the United States as opposed to the existing GSL program. As the attached analysis indicates, the promised savings associated with a direct loan program are simply not there. If the actual costs of direct loans are recognized rather than the partial costs currently identified by the GAO and the CBO, there will be no savings to the Federal Treasury, and no additional source of funds that can be used to support other financial aid programs.

Sallie Mae's analysis shows that, when all of the costs are accounted for, direct loans will cost the federal government $159 million more in the first year than a comparable amount of guaranteed student loans. In addition to the federal costs, other program partners -- schools, servicers and others -- will need to allocate nearly $500 million to create the administrative mechanisms necessary to run a direct loan program. Assuming that a direct loan program delivers the same amount of aid to students as the existing guaranteed loan program, no federal savings would be available as a result of the switch to direct loans until at least Fiscal Year 2005, and even then the savings would be minimal.

Direct Lending Will Not Simplify Loan Administration

While at first blush direct loans may appear to be simpler to administer than guaranteed student loans, there is, on further reflection, no support for this assumption. The direct loan program would necessarily involve the development of a complex system of funding mechanisms, none of which currently exist, and a vast increase in the administrative (and cost) burden for schools. Direct lending would have to be administered through a massive federal data system that would dwarf, in size and complexity, the often promised but as yet unimplemented National Student Loan Data System. As proposed, direct loan allotments would be disbursed to schools through a funding channel that begins at the Federal Treasury and ends at the financial aid or business offices of more than 9,000 schools or their lending agents. Schools would have to request funds in an application submitted well in advance of the commencement of each school year, based on the estimated need of their students, and disburse funds directly or through agents to each student individually via check or credit to their account. The efficient delivery of loan funds would be dependent on the centralized federal data system and its ability to successfully interact with funding agents and intermediaries in order to deliver loan dollars to schools. Following each transaction involving the school would be a comprehensive audit trail that would have to account for the loan fund whether managed by an agent or directly, track full and partial loan cancellations to borrowers who never enroll or leave school early enough to qualify for a refund, and serve as back up for the funding requests made to the federal government. Schools that did not initially receive sufficient funds based on their estimates would have to reapply to the federal government for additional allotments in the hope that these funds would be made available in time to meet the needs of students. Students that enroll at

less traditional times, such as those attending schools with trimester systems, or those undertaking independent programs, would be especially exposed to delay as would those students whose need for financial aid did not arise until after the start of the school year.

Direct lending would not necessarily simplify the loan process for students or parents. Most student loan borrowers obtain their loan applications through the school today, as they would under a direct loan program. Borrowers who attend more than one school (e.g., community college students that articulate into four-year schools, or undergraduates who continue their studies as graduate students) would, by definition, obtain their loans through multiple lenders and would, likely, have their loans serviced at multiple sites. These students would not have the option, as they do today, to receive all their loans through a single lender; nor would parents whose children attend different schools be able to obtain loans from a single source. Since few schools will service direct loans once they enter repayment, accounts will be transferred to loan servicing agents just as most are under the existing guaranteed loan program. Any advantage envisioned in the borrower's dealing directly with the school will disappear as soon as repayment begins; schools will have no more impact on the borrower's repayment behavior on direct loans than they do with regard to loans made today under the current system, and they will still be held accountable for loan defaults.

Students Could Not Rely on the Availability of Direct Loans

The reliability of the system of loan delivery is key to the issue of student access to higher education. In the current GSL system, loan capital is available virtually on demand, regardless of the stage in the academic year it is requested or the school's expectation of need for such funding. Recent innovations in GSLP loan delivery, as well as the constant spur of a competitive marketplace, have significantly reduced the processing time for loan applications, minimized the paperwork burden on schools, and helped to ensure that funds are available to students in a timely fashion. The inherent constraints of a federally directed system prevents the delivery of funds to students from being as efficient or reliable as the current model. This is because of the built-in limitations of any single source of funds system; the time-consuming cumbersomeness of annual school-by-school application for funds based on estimates of need and demand, which are then reviewed by the Government for reasonableness; and because there is no market-driven incentive for the Government to move expeditiously in approving and supplying the needed funds. In point of fact, the Government

saves money as the delivery system bogs down and funds are held longer by the Treasury. Given its recent track record in performing its limited tasks under the existing GSLP, there is good reason to be concerned about the ability of the Department of Education to deliver the services necessary to ensure the uninterrupted flow of loan capital to students and parents. It is instructive to recall that the program of federally insured loans in which the government directly insured loans under the GSLP gave way to a program of insurance by guaranty agencies largely due to management inefficiencies and failures of the central government. As if in remembrance of this recent history, the Secretary of Education recently advised the Congress "this Department is not currently prepared for such tasks." In addition, there is always the risk of a short-fall in appropriations for, or administratively imposed restraints on, the use of funds appropriated to support the government's loan delivery system operations. When direct loan funds are not delivered when needed, schools will have no choice but to, in effect, provide the necessary interim student financing from their own resources. Students attending schools that cannot provide this "float" will be unable to meet their educational costs and may have no choice but to withdraw.

Direct Lending Will Increase the Administrative and Financial Burdens on Schools

There can be little doubt that the administrative burden (and expense) for schools will increase dramatically under a direct loan model. Today some schools may have to deal with a large number of guaranty agencies on a regular basis and occasionally directly with loan holders, but their interaction is, as a rule, limited to supplying current information as to whether the borrower is still enrolled in school. Under direct lending, schools will still have to report borrower status and other information to perhaps a large number of government collection contractors, as well as the government itself, who will be attempting to respond to borrower inquiries. In addition, of course, schools will be responsible for the opening of "teller windows" to deliver funds to students; executing promissory notes; issuing checks to students; maintaining student loan records, including the safe-keeping of promissory obligations, in accordance with federal requirements; ensuring that in making loans they are in compliance with local consumer protection laws; complying with all federal regulations and other issuances governing their administration of the loan program; and preparing for extensive federal audits and reviews of their operations. This is in addition to the loan counseling and eligibility determination responsibilities they perform under existing program rules. Schools will be stepping up for these

responsibilities based on the promise of a flat-fee administrative allowance from the federal government, unrelated to the actual costs they incur. Given the checkered history of the Government in meeting its obligations to fund such allowances for other aid programs, including the GSLP, and the extent and potential price-tag of their administrative duties, there is no assurance that such an allowance will either cover the costs of schools or be available to them in a consistent and timely manner.

Direct Lending Will Not Provide Schools With More Freedom or Control Over Student Lending

While the direct loan program necessarily shifts burdens and risks currently borne by others to the schools, the schools will receive little, if any, offsetting benefits in the form of additional control and discretion. The rules governing the eligibility of students and parents, the amounts they are entitled to borrow, the needs to be met, the repayment terms, the timing of disbursements to borrowers, the processes and record-keeping to be employed, will all be determined by federal rules as is the case today in the GSLP. On the other hand, the amount of federal oversight required to monitor the direct use of federal funds and its collection can be expected to be an order of magnitude increase over the GSL. This follows from the fact that, while financial institutions are subject to independent oversight by financial regulators, there can be no such reliance when loans are made by schools -- the Department of Education will have to assume the role of financial and program overseer. Given that the GAO, the Inspector General, Members of Congress, and others have been pointing to a need for increased monitoring of federal financial assistance programs, it can be expected that the Department of Education will be required to commit itself to the adoption of strict oversight policies and procedures commensurate with the increased financial and administrative responsibilities assumed by schools in direct lending. Accordingly, colleges and universities may well find the oversight, review, and auditing procedures that will necessarily be instituted by the Federal Government to be time consuming and costly, occupying considerable staff time of financial aid and business offices. Building on recent trends, it could also be expected that the heavy presence of a federal regulator (or its agent) might ultimately lead to unwanted federal interference in traditional areas of institutional jurisdiction such as admission standards, affirmative action, tuition charges, and the packaging of financial aid.

Direct Loans Place Schools at Financial Risk

Schools will be stepping up for a great deal of risk and uncertainty as a consequence of their participation in a direct loan program. Under the current GSLP, approximately 11 percent of all loan default claims are not paid by guaranty agencies or the Federal Government due to defects in their origination or servicing. This risk is borne primarily by loan holders, with the remaining portion being assigned to servicing agents. Presumably, a direct loan model will assign the risk of non-compliance to the school and the loan collection contractors.

Since the school is responsible for disbursing the loan to the student, it will bear primary responsibility for errors in loan origination. If, for example, the promissory note is not properly completed, if the loan was not made for an amount allowable under the needs provisions of the program or is in excess of annual or multiple year aggregate limits, if the funds are disbursed to the student too early or too late in the academic year, or if the origination audit trail is not sufficiently detailed, the school will be expected to bear the financial consequences of its mismanagement of federal funds. These risks are added to the risks of loss that schools currently operate under in connection with their certifications of borrowers for GSLP eligibility -- if the borrower is incorrectly certified by the school, the guaranty agency or the Secretary requests recompense for the benefits paid on the loan. As direct lenders, schools can expect to have to defend themselves against a rising tide of borrower lawsuits alleging that they did not receive the education they were promised or that the school did not comply with applicable state or federal disclosure or other consumer protection laws and that, therefore, they should not be responsible for repaying their loans. Borrower success in such suits results in an unenforceable loan for which the Government will expect the school to reimburse the Treasury. Schools that choose to act as collectors of direct loans will be stepping up for even greater risk in that they will also be held financially accountable for all errors in the servicing of direct loans.

As lenders under the GSLP can attest, there is no small amount of risk in originating and servicing student loans. As a profit-making financial institution, a lender expects to absorb some of the losses associated with that risk. It is an inherent part of its business, and it has the expertise necessary to limit those risks. Public and non-profit private entities, such as two- and four-year colleges will have no loan earnings to offset such losses and may be ill-equipped to keep them at a minimum. State-supported schools will encounter additional difficulties in having to use public funds to offset penalties assessed due to its

administrative failures in regard to making or servicing direct loans.

The Quality of Loan Administration and Services Will Decline Under Direct Lending

One of the inherent advantages of the Guaranteed Student Loan Program and its reliance on the private sector to supply capital and perform critical functions is the benefits derived from competitive market forces. The interplay of these forces results in the continual development of products and services designed to enhance the quality of loan administration. Loan servicers, lenders, secondary markets, software developers, and guaranty agencies are among those who are spurred by the competitive pressures of the marketplace to develop and maintain quality products which deliver increasingly efficient services to schools and students. In recent years, for example, these partners in the GSLP have put on the market: faster, less paper-oriented ways to deliver funds to students and schools; automated, overnight loan guarantee systems; debt management software packages; sophisticated, desk-top loan origination and management systems for lenders and schools; automated, dial-up loan inquiry systems for students and schools; advanced collection techniques; and servicing systems capable of offering borrowers a wide range of repayment options. Experience tells us that this type of competitive strive for quality is the exception rather than the rule in centrally administered federal systems. Rather than taking advantage of the diversity of the marketplace and the full capacities of service providers, federal contracts generally force all providers to a middle-ground, where minimum contractual standards are met and federal cost limitations are paramount. There is little incentive for a federal service provider to develop expensive systems or innovative new techniques, when there is no assurance that an existing contract will be renewed (typically in a two- or three-year cycle) and when low cost is generally given precedence over imagination or resourcefulness. In setting qualification standards, the federal government will have to be careful not to raise its standards too high, or it will risk not having enough bidders to keep the price in line. The end result of such a move away from the private sector will almost certainly be a diminution in the level of customer service received by schools and students and a dampening of provider willingness to perfect their products.

Direct Loans Will Tend to Further Undermine the Integrity of the Student Loan Program

Student loans have found themselves under increased scrutiny in recent years. This is largely due to the rising federal costs of loan defaults and reports of fraud and abuse, primarily among a limited number of schools participating in the loan programs. Recent Congressional hearings and reports by federal agencies have pointed out the poor track record of the Department of Education in policing the loan program participants, in unearthing evidence of fraud, and in successfully stemming the flow of federal funds to schools that are abusing federal funds or defrauding students. While there are admittedly an alarming number of bad apples in the student loan barrel, their number has been limited by the oversight carried out by guaranty agencies in their areas of jurisdiction. Guaranty agencies have become the primary enforcers of student loan rules and the first line of prevention against those who would abuse the loan program. By conducting comprehensive program reviews, working closely with local law enforcement and consumer protection agencies, and investigating borrower-initiated complaints, these agencies have successfully prosecuted persons involved in loan fraud and stripped undeserving schools of their loan eligibility. Under direct lending, the overall integrity of the program can be expected to decline as the network of program overseers shrinks and the protection of student borrowers vanishes. As the integrity of the program continues to be undermined, the continued viability of student loans as a form of student assistance and its political foundation will be called into question.

All oversight responsibility in a direct loan program would fall to the Department of Education, which has repeatedly proven that it is incapable of carrying out its currently more limited responsibilities under the GSLP. The existing expertise of guaranty agency program review teams and their ability to coordinate with local agencies would be lost. The opportunities for fraud and abuse would multiply greatly and the chance of preventing such activities would be severely diminished. Because of their local positioning, many guaranty agencies have been able to stop acts of fraud before they are widely perpetrated. The same is not true of the federal government which historically has been slow to react and generally only takes action after a widespread fraud has become a matter of public knowledge.

Also lost under a switch from guaranteed to direct lending is the effect of the credit marketplace on students' decisions on where to attend school. Currently, if a borrower encounters difficulty in obtaining a loan for attendance at a certain school he or she may seek out the reasons why and find that the

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school's default rate may be excessive or that the educational program has not translated into a high rate of job placement. This is the type of result that the Department of Education has hoped for when it recently encouraged lenders to take a more careful look at the types of schools for whose students it makes money available. If such a student goes so far as to contact a guaranty agency lender of last resort program, the borrower will most probably receive additional counseling and a list of alternative programs that offer similar training. Students seeking direct loans will obviously not be provided with any such counseling on alternative programs at other schools or with early warning that the program they are intending to enroll in may not be their best option. Student borrowers will be a captive audience of the school and will not have the benefit of information on program quality supplied by impartial sources, such as the lender or guaranty agency.

THE REAL COSTS OF DIRECT LENDING: A COMPREHENSIVE ANALYSIS

Its proponents argue that a direct loan program will save the federal government millions of dollars each year in comparison to the costs of the existing Guaranteed Student Loan Program and free up funds for use in other financial aid programs. To examine these claims in more detail, Sallie Mae conducted a comprehensive comparative cost analysis of direct lending versus guaranteed loans. The following highlights the results of this examination. The full analysis, including supporting documentation, is available from Sallie Mae on request.

DIRECT LOANS DO NOT COST LESS THAN GUARANTEED STUDENT LOANS, IN FACT THEY COST MORE

- Reports of cost savings associated with direct lending have relied on a new generation of "smoke and mirrors" stemming from Credit Reform legislation enacted in 1990. These reports count, for budget cost purposes, only the costs of the loan subsidies and neglect both the ongoing federal administrative costs of direct lending and the program costs of direct lending that are borne by others, such as colleges.

- Taking all expenditures of taxpayer funds into account, the total costs to the government of the first year of direct lending will be **$159 million more** than the cost of a comparable amount of guaranteed loans.

- When other costs borne by parties other than the federal government are added to the expenditure of taxpayer funds, the total cost of the first year of direct loans will be $647 million more than it would be in the GSLP.

- The government will not begin to save any money as a result of direct lending until at least Fiscal Year 2007 and, even then, the savings will be minimal.

TO DATE, ANALYSES OF DIRECT LENDING HAVE UNDER-STATED THE COST OF DIRECT LOANS

- The actual cost experience in the GSLP tells us that the costs of servicing direct loans will be considerably higher -- as much as 400% higher -- than the amounts factored into Congressionally sponsored cost analyses.

- The switch to direct lending will require the federal government to make a multi-million dollar investment in personnel and data processing resources. These start-up costs, estimated at $82 million in the first year, are not recognized in any other cost estimates.

- The inefficiencies associated with abandoning the established network of loan providers and replacing them with a new set of players who will not have the same incentives, experience or capital will result in an increase in loan defaults and heightened opportunity for program abuse.

- Existing costs analyses do not address the additional costs and government borrowing (estimated at 1 billion for the first 5 years) required to ensure borrowers' future ability to consolidate their direct and guaranteed loans.

- Additional borrowing by the federal government will adversely increase the cost to the government of direct loans and add to the national debt. These costs have not been taken into account by other analysts.

SCHOOLS WILL NOT BE ADEQUATELY REIMBURSED FOR THE COSTS THEY INCUR IN MAKING DIRECT LOANS

- Conservatively, schools will have to spend $420 million to prepare themselves to administer direct loans.

- Once they are operationally ready to deliver direct loans to students, schools will find that their costs of originating direct loans will be up to three times greater than the $20 per loan the government proposes to reimburse them for their services -- this means that schools will be spending as much as $120 million each year out of their own pockets to cover the costs of making direct loans, in addition to the costs they will incur for their other administrative duties under a direct loan program.

- Schools will be expected to shoulder the risk for any loans that are not made in strict compliance with federal standards and to reimburse the U.S. Treasury for loans that are not properly originated.

Student Loan Marketing Association
GSLP Program vs. Direct Lending Program Cost Comparison
$9 Billion Loan Cohort

(present value dollars in millions) (1)

	Budget Year – FY 1992		GSLP Better/(Worse) Than DLP
	GSLP	DIRECT LOAN	
I. Subsidy Costs:			
Origination Fees	$ 391		
Reinsurance Fees	15		
Stated rate/Special allowance	(1,704)		
Defaults less collections	(1,052)		
Interest income		$ 1,822	
Principal payments		3,821	
Collections		524	
New funds (2)		(7,350)	
Total subsidy costs:	**(2,350)**	**(1,183)**	**$ (1,167)**
II. Administration Costs:			
ACA	(63)		
Tax revenue offset	189		
Administrative expenses	(89)	(171)	
Origination/Servicing fees		(608)	
Collection fees		(269)	
Total administration costs:	**37**	**(1,048)**	**1,085**
III. Other Government Costs:			
Additional cost of funds		(63)	
USDE lender of last resort		(96)	
USDE systems		(82)	
Total other costs		(241)	241
TOTAL GOVERNMENT COSTS	**(2,313)**	**$ (2,472)**	**159**
IV. Servicer/School Costs:			
School/servicer capital costs		(459)	
Contractor loss liability		(29)	
Total servicer/school costs		**(488)**	**488**
TOTAL PROGRAM COSTS	**(2,313)**	**(2,960)**	**647**

(1) *Cash flows discounted at 6.3% (7 yr. treasury note projected rate)*
(2) *Cash flow is net of origination fee (5%) and guarantee fee (1.6%)*

Issues for Consideration

We encourage your consideration of these issues. You may wish to consult with institutional leadership, your business office, and any other interested institutional personnel. Questions have been categorized into operational or policy areas. Where possible, the section numbers of the draft legislation have been included for your reference.

Operational Issues

1. Section 451: The language in section 451(d) states that "An institution whose application has been approved by the Secretary under section 452(b) shall be deemed to have a contractual obligation from the United States for making the payments specified in that application." Is this an open entitlement covering all eligible students, or only for the amount specified on the application?

2. Section 451: Pursuant to section 451, the Secretary is required to make initial payments available to institutions by July 1 of the academic year which begins after that date. Additionally, as part of the application that must be submitted to participate in the program, IHEs must estimate the needs of the students at their institutions. The initial payments to IHEs will be based on these estimates. Assuming that the deadline for submitting these estimates will need to be well before April 1 (when the Secretary must issue bonds to finance the program pursuant to section 457), will IHEs be able to accurately estimate their need for loan funds, especially in light of the unsubsidized loans which parents may borrow to replace EFC? From the draft bill description, it is unclear whether or not schools will have an opportunity to adjust their funding requests later in the year. Should more detail be provided, or should we assume that the Department will accommodate this in regulations?

3. Section 451: It appears that the language in the bill does not provide for subsequent payments to institutions if their estimates are incorrect except in section 451(c)(2) where it states that "Payments of entitlements by the Secretary under this part shall be made promptly." Is this provision adequate to ensure that IHEs will have the funds they need to administer the program? Institutions may perceive "promptly" to mean prior to disbursement. Will the Treasury or ED be motivated to provide this assurance or will current contract reimbursement procedures be followed, which usually does not insure payment until 30 to 45 days after the expense has been incurred? If IHEs are given only one opportunity to receive funds, will this be an incentive to grossly overestimate need? Given the multiple disbursement requirement in section 454(d), the bill does not specify what portion of the total estimated (or actual) need for funds IHEs will receive as an initial payment. Should this be specified in the statute? If IHEs receive the estimated amount needed for the entire academic year as an initial payment, what is an IHE to do with the year's loan funds prior to subsequent student disbursements? Is it likely that the Treasury would want to advance all of these funds to schools up front? If not, how will the funds flow to the school?

4. Section 452: The Secretary shall establish the application deadline dates and information on the application to ensure the correctness of the institution of higher education's (IHE's) estimated need for funds. What constitutes "correctness"? If the Secretary disagrees with the institution's estimate of need, could he/she approve a lower amount? Do schools have any ability to appeal? What information would a school provide to justify its request?

5. Section 452: In lieu of reimbursement for its expenses in administering its student loan program, IHEs are entitled to a payment in accordance with section 489 OR an amount equal to $20 per academic year for each student enrolled in that IHE who receives a loan. (These payments are also established as an entitlement). Is $20 a reasonable payment for an institution? Could your institution participate without the fee? Schools will obviously have some additional administrative responsibilities under a direct lending program as well as being relieved of other administrative tasks. In comparing these responsibilities, do you feel that this will be more work or less work for your institution? Do you have adequate staff to carry this out or will your school have to add additional resources?

6. Section 452: In section 452(b)(3) it states that "the note or evidence of obligation on the loan shall be the property of the Secretary and that the IHE will act as the agent for the Secretary ONLY for the purpose of making loans under this part." Where does institutional liability begin and where does it end in this process? If a loan was improperly originated or fails to include a required statement or signature, is the school liable for it until it is resolved? Will ED have the authority to disable any incomplete or improper loan? How will these decisions be made and how will differences be reconciled?

7. Section 453: Should there be a provision to preclude students who are near the maximum aggregate loan limits in the part B programs during the phase in of the direct loan program from borrowing under new aggregate limits? Will schools be responsible for monitoring both the annual and cumulative loan limits or will this be check by ED? Will schools be required to interface with the separate data system required by proposed section 456? How will this work for transfer students if it is not done centrally?

8. Section 456: Since institutions will have primary responsibility for administering the direct loan program, is it logical to assume that they will be subject to more extensive auditing requirements than under current law? What will these be? What additional costs related to such audits could schools anticipate?

Broader policy questions

1. IHEs initially selected to participate would be allowed to provide students with larger loans that would a non-participating school. Inclusion of these higher loan limits assume that the participating school will no longer be able to make Perkins loans. Will all non-participating schools have enough Perkins and Stafford funds to match the aid packages offered by a participating school? If not, does this create problems of equity in trying to package student aid?

2. In the event that the direct lending program becomes inoperable, are adequate safeguards provided that would allow the GSL program to continue operating with assurances that all participating institutions would have access to such funds for their students?

3. Is it reasonable to assume that all currently participating in the GSL program can administer a direct loan program? If schools are the direct recipients of funds, will this impact their pricing policies?

4. Many lenders do provide borrowers with a number of services. In addition, many of the lenders also help to cover costs for schools with their informational and counseling materials. Will this impact your operations? Can you provide these services to students?

5. During the phase-in of the program, there has been concern that decreased volume may negatively impact the currently participating entities. Will lenders continue to participate? If not, will this impact schools who are not initially selected to participate in the direct lending program? Will guaranty agencies be able to continue their operations without interruption or will we see many of them becoming insolvent similar to the phase-out of HEAF? If a guaranty agency has to be shut down before the direct lending program is fully operational, who will be charged with fulfilling their role? Will schools in these states be assured of continued service and access to GSL? Will the changes have any impact upon current holders of notes, including letter of credit agreements, and other secondary market operations? Is ED willing and able to cover these possibilities so as to insure an orderly transition?

6. How might the political alliances be affected if some participants in the GSL Program are eliminated?

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